

STATE INVESTMENT COMMISSION
MINUTES
September 22, 2004

The State Investment Commission (the "Commission") was called to order by Chairman Jonathan Miller, at 2:00 p.m. in Room 264 of the Capitol Annex. Members present were Mike Alexander, proxy for Governor Ernie Fletcher; Tom Howard, proxy for Robbie Rudolph, Secretary, Finance and Administration Cabinet; and Jonathan Miller, State Treasurer.

Treasurer Miller confirmed that a quorum was present and that the press had been notified of the meeting.

A motion was made by Mr. Howard and seconded by Mr. Alexander to approve the minutes of the June 8, 2004 meeting. Motion **CARRIED**.

Mr. Dwight Price, portfolio manager, Office of Financial Management, gave an update on the Commonwealth's portfolio. Mr. Price stated that the portfolio is beginning to stabilize and has grown to approximately \$2.8 billion. Interest rates have risen slightly and remain fairly constant within a trading range. He stated that the Fed raised interest rates by 25 basis points on September 21, which was expected, and the market actually rallied on the news. Mr. Price indicated that the yield curve was flattening. He continued that the portfolio continues to slightly outperform the index.

Treasurer Miller stated that the president of Western Kentucky University ("WKU") informed him that the University suffered a loss of between \$600,000 - \$800,000 in investments. Mr. Price indicated that it was possible in April 2004 that WKU's investments could have suffered a "paper loss". He continued that the Intermediate Pool is a total return portfolio, which means that staff values the securities every night. He pointed out that when interest rates rise, the value of the securities drops. Mr. Price stated that this also happened in July 2003, and in both instances, there was only a temporary loss. Mr. Price further stated that 2004 was a very difficult year for the Intermediate Pool and the securities in the pool earned slightly over 1 percent on a total return basis.

Mr. Howard stated that the alternative would be to invest at 1 percent or less in an overnight or money market fund versus the Intermediate Pool with an average maturity of 18-24 months with coupons of 2.5 or 3 percent. He further stated that while the market value of the Intermediate Pool may change as interest rates move, the incremental return over the holding period is worth the variability.

Mr. Steve Jones, portfolio administrator, Office of Financial Management, informed the Commission that a TRAN was issued this year. He indicated that staff borrowed \$500,000,000 in July at a fixed rate of 1.55 percent at the end of June. In addition, staff entered into a fixed receiver interest rate swap with Citigroup at 2.22 percent, making approximately 70 basis points in earnings. He continued that the swap pays one month LIBOR to Citigroup and that the assets are invested in one-month LIBOR type assets and is expected to break even. Mr. Jones indicated that the earnings would come from the spread on the fixed swap versus the fixed rate debt in an amount expected to be in excess of \$3 million. Mr. Jones stated that the Kentucky Asset/Liability Commission approved the interest rate swap at its May meeting.

Mr. Howard indicated that full disclosure of the swap is included in the Semi-Annual report, which will be distributed to the members by the end of September.

Treasurer Miller asked if there was any new business before the Commission. Mr. Price indicated that Mr. Howard is currently the acting executive director of the Office of Financial Management and a motion to elect him secretary of the Commission was necessary. A motion was made by Mr. Alexander to appoint Mr. Howard secretary of the Commission. Motion **CARRIED**.

Mr. Price indicated that staff would be rewriting the accounting software, which takes earnings and allocates them to all the state's cash accounts. Mr. Price indicated this is the third time that staff has rewritten the software and results from pending changes to the CAMRA system.

With no further business before the Commission, a motion was made by Mr. Howard to adjourn the meeting. Motion **CARRIED** and the meeting adjourned at 2:15 p.m.

Respectfully submitted,

F. Thomas Howard, Secretary
State Investment Commission